

In the Matter of the Appeals of )  
JOHN C. AND MARY L. STANSFIELD, )  
CLIFFORD AND IRENE PRATT, AND )  
MINES SUPPLY AND LUMBER COMPANY )

For Appellants:            Lawrence A. Nestel  
   Attorney at Law

For Respondent:        Bruce W. Walker  
                                 Chief Counsel

Paul J. Petrozzi  
Counsel

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John C. and Mary L. Stansfield against proposed assessments of additional personal income tax in the amounts of \$878.90, \$2,069.00, and \$899.80 for the years 1969, 1970, and 1971, respectively, from the action of the Franchise Tax Board on the protest of Clifford and Irene Pratt against proposed assessments of additional personal

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income tax in the amounts of \$499.20, \$1,420.00, and \$520.86 for the years 1969, 1970, and 1971, respectively, and, pursuant to section 25667 of the Revenue and Taxation Code, from the action of the Franchise Tax Board on the protest of Mines Supply and Lumber Company against a proposed assessment of additional franchise tax in the amount of \$1,180.82 for the taxable year 1972.

During 1969, 1970, and the first half of 1971, John C. Stansfield and Clifford Pratt (hereinafter appellants) were equal partners of a partnership doing business as Mines Supply and Lumber Company (hereinafter Mines). On July 1, 1971, Mines commenced doing business as a California corporation.

The primary issue presented by these appeals is whether respondent erred in disallowing certain partial bad debt deductions reported by Mines in its partnership returns for the years 1969, 1970, and 1971.

During 1963 Mines furnished construction materials to Mr. Ozzie Lovgren on the basis of an open book account. As of December 31, 1969, Mr. Lovgren owed the partnership \$43,000.. In response to an inquiry from appellants, Mr. Lovgren **promised to pay \$23,000 to Mines in 1970.** Mr. Lovgren also promised to reorganize his business affairs. On the basis of these circumstances, Mines continued to supply materials to Mr. Lovgren. However, Mines charged off \$20,000 of the \$43,000 debt in 1969.

Early in 1970, Mr. Lovgren **made payments** to Mines in the total amount of \$13,000 **and assigned \$60,944** of his own accounts receivable to the partnership. In May 1970 appellants learned that **the** accounts receivable had previously been assigned to other parties and, therefore, that the accounts were worthless to Mines. At that time, Mr. Lovgren's indebtedness **to** the partnership had increased to approximately \$85,000. Accordingly, Mines ceased supplying materials to Mr. Lovgren and filed suit to recover the amount owed.

Sometime thereafter, apparently in the latter part of 1970, Mines obtained a judgment against Mr. Lovgren for the amount of \$85,719. On the basis of appellants' belief that Mr. Lovgren owned only \$28,000 worth of assets subject to execution, Mines charged off an additional \$37,649. Thus, by December 31, 1970, Mines had charged off \$57,649 of Mr. **Lovgren's** total indebtedness to the partnership. A final charge-off of \$28,277 was made in 1971 when it became evident to appellants that no portion of Mr. Lovgren's debt was collectible. Apparently, Mr. Lovgren continued making Small payments to Mines until February 11, 1971.

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In its partnership returns for the years 1969, 1970, and 1971, Mines deducted as partial bad debts the respective charge-offs against Mr. Lovgren's indebtedness. After conducting an audit of the returns, respondent disallowed the deductions on the ground that appellants failed to establish the partial worthlessness of Mr. Lovgren's debt in the amounts and for the years claimed.

Section 17207 of the Revenue and Taxation Code governs the deductibility of bad debts. Subdivision (a)(2) of section 17207 provides:

When satisfied that a debt is recoverable only in part, the Franchise Tax Board may allow such debt in an amount not in excess of the part charged off within the taxable year, as a deduction.

Subdivision (a)(2) of section 17207 is identical to section 166 (a) (2) of the Internal Revenue Code of 1954. Accordingly, the interpretation and effect given the federal provision are highly persuasive with respect to proper construction of the state law. (Holmes v. McColgan, 17 Cal. 2d 426, 430 [110 P.2d 428] (1941); Rihn v. Franchise Tax Board, 131 Cal. App. 2d 356, 360 [280 P.2d 893] (1955).)

The federal courts have interpreted section 166 (a) (2) as conferring a discretion upon the Internal Revenue Service which, although not boundless, requires the administrative determination as to deductibility to be upheld unless plainly arbitrary or unreasonable. (H. W. Findley, 25 T.C. 311, 318 (1955), affd. per curiam, 236 F.2d 959 (3d Cir. 1956); Wilson Bros. & Co. v. Commissioner, 124 F.2d 606, 609 (9th Cir. 1941); Portland Manufacturing co., 56 T.C. 58, 72-73 (1971).) In this regard, the burden is upon the taxpayer to establish that in the year the partial worthlessness was claimed, the amount of such worthlessness could be predicted with "reasonable certainty." (Trinco Industries, Inc., 22 T.C. 959, 965 (1954); Wilson Bros. & Co. v. Commissioner, supra, 124 F.2d at 610.) Specifically, the partial worthlessness of the debt in question "must be evidenced by some event or some change in the financial condition of the debtor, subsequent to the time when the obligation was created, which adversely affects the debtor's ability to make repayment." (H. W. Findley, supra, 25 T.C. at 319.)

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Applying these principles in the instant appeals, we are unable to conclude that respondent's action in disallowing the partial bad debt deductions for the years 1969, 1970, and 1971 was either arbitrary or unreasonable.

At the outset, we note that the record on appeal contains somewhat less than a detailed description of the facts and circumstances surrounding the claimed deductions. 'No evidence whatsoever has been presented on appellants' behalf concerning the nature or financial condition of Mr. Lovgren's business during the years in question. Moreover, the record contains no evidence indicating that Mr. Lovgren discontinued, or planned to discontinue, operation of his business either during or subsequent to such years. Finally, other than a general allegation that Mr. Lovgren owned no assets which might provide a source of recovery for the partnership, appellants have submitted no information concerning the personal financial status of Mr. Lovgren during or subsequent to the years in question.

While a creditor's -judgment as to worthlessness is entitled to consideration, the decision to write off part of a debt must be supported by the facts in the record. (Portland Manufacturing Co., *supra*, 56 T.C. at 73.) A physical charge-off, in itself, is not sufficient to establish the claimed amount of partial worthlessness. (See H. W. Findley, *supra*.) On the basis of the meager record before us, we conclude that appellants have failed to establish with "reasonable certainty" what part, if any, of Mr. Lovgren's indebtedness to Mines was **worthless at the close of each of the years in question.** In the absence of a clear indication that a change in the financial condition of Mr. Lovgren or his business occurred during 1969, 1970, or 1971 which adversely affected his ability to 'make repayment, we must sustain respondent's action in disallowing the claimed partial bad debt deductions.

In addition to the partial bad debt deductions claimed by Mines as a partnership, respondent disallowed certain bad debt deductions claimed by Mines on its franchise tax return for the taxable year **1972.** The record on appeal contains no argument whatsoever by the corporation's representative concerning these deductions. Accordingly, we must also sustain respondent's action in disallowing the bad debt deductions of the corporation.

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## ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of John C. and Mary L. Stansfield against proposed assessments of additional personal income tax in the amounts of \$878.90, \$2,069.00, and \$899.80 for the years 1969, 1970, and 1971, respectively, that the action of the Franchise Tax Board on the protest of Clifford and Irene Pratt against proposed assessments of additional 'personal income tax in the amounts of \$499.20, \$1,420.00, and \$520.86 for the years 1969, 1970, and 1971, respectively, and, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Mines Supply and Lumber Company against a proposed assessment of additional franchise 'tax in the amount of \$1,180.72 for the taxable year 1972, be and the same are hereby sustained.

Done at Sacramento, California, this 9th day of May, 1979, by the State Board of Equalization.

William W. Bennett, Chairman  
 Philip K. ... , Member  
 ... , Member  
 ... , Member  
 ... , Member